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## FISCAL IMPACT REPORT

**ORIGINAL DATE** 2/2/16  
**LAST UPDATED** 2/9/16      **HB** 174a/HBEC  
**SPONSOR** Egolf  
**SHORT TITLE** Suspension of Some Property Tax Increases      **SB** \_\_\_\_\_  
**ANALYST** Graeser

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
	(*)	(*)	(*)	(*)	Recurring	State GOBs and GOB Capacity
	(*)	(*)	(*)	(*)	Recurring	Local Gov't/Schools Operating
	(*)	(*)	(*)	(*)	Recurring	Local Gov't/Schools GOBs

Parenthesis ( ) indicate revenue decreases

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>						

Parenthesis ( ) indicate expenditure decreases

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

New Mexico Municipal League  
 Department of Finance and Administration (DFA)  
 Economic Development Department (EDD)  
 State Land Office (SLO)

### SUMMARY

#### Synopsis of Amendment

HBEC amendments to HB 174 make the provisions of the bill applicable for the 2017 tax year and clarify that the 3% annual valuation cap does not apply to properties granted a suspension of valuation increases.

Synopsis:

HB 174 would permit a county or municipality to enact an ordinance suspending property valuation increases for ten years on approved commercial enterprise development projects. Projects must create jobs, promote industry, trade or other economic activity or any other criteria set forth by the governing body. For a project to qualify for the suspension in valuation increase, the taxpayer must own the property and have plans to develop a commercial enterprise on the property and apply for the suspension of valuation increase on a prescribed form. The county or municipal ordinance must also contain a method to appeal if project is denied the suspension. The County Assessor is notified if the application is approved and maintains the value of the property at the value the property was the year before the project began. Multi-unit residential properties are considered a “commercial enterprise” and single-family units are not.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (May 18, 2016). The earliest the provisions of this bill could affect revenues to local jurisdictions would be FY 19. The first property tax year that could be affected would be 2017 (and more likely, because of a lengthy approval period, TY 2018. Payments for the 2017 tax year are due in November 2017 and April 2018. Payments for the 2018 tax year are due in November 2018 and April 2019. HBEC amendment makes clear that the provisions of the bill would be applicable for the 2017 taxable year.

**FISCAL IMPLICATIONS**

There are two widely disparate interpretations of the provisions of this bill. The first (from EDD) is that the commercial project would be built and the bill’s provisions would then freeze the new value for ten years. The second (from NMML and DFA/LGD) is that a local jurisdiction would agree to freeze the property value at the raw land value for ten years. Obviously, these two extremes would have substantially differing impacts. A very careful reading of the bill indicates that the NMML/DFA interpretation is probably correct. Page 1, line 23, “ten-year suspensions on increase in valuation for property tax purposes of the property on which commercial enterprises are developed, **starting in the year the commercial enterprise development project begins.** Thus, a piece of bare land zoned commercial and with utilities to the lot line is valued in 20xx at, say, \$1,000,000. A \$10 million building begins construction in the spring of 20xx and is finished by November and is occupied. The value as of January 1, 20xx +1, in the absence of the provisions of this bill, would be \$11,000,000 plus the value of contributed labor. If the approvals are in place prior to starting construction of the “big house”, then the valuation for TY 20xx +2 would be \$1,000,000, the value of the land 90 days before negotiations to purchase the land had even been contemplated.

According to EDD, “...this legislation will have no impact on the state budget and will have minimal impact on the county or municipal entity enacting the suspension. The suspension freezes values at the current value it does not decrease in any way the current tax being collected on the property, therefore the fiscal impact is negligible. The enacting entity has the authority and fiduciary responsibility to review and determine if the activity will result in positive economic activity. Said economic activity should be sufficient in creating additional GRT and other economies to outweigh any losses in property tax during the suspended period.”

However, NMML takes a contrary view and is concerned with a number of issues, “...the main fiscal implication for the local entity would be a diminution in the amount of property tax

revenues that the entity would receive from the affected commercial property. This might be offset to some extent by the gross receipts taxes that would be generated by the enterprise, an enterprise that might not have come to the county or municipality but for the property tax exemption. Nothing in the bill sets a timeframe during which development must occur, but perhaps that could be left to local ordinance specifications.”

NMML continues, “...the bill provides solely for a ten year period during which property tax valuation increases will be suspended. The bill does not provide or permit a local governmental entity to approve a suspension in valuation increases for any period short of 10 years.”

“The bill provides that a taxpayer that applies for and is denied a suspension on increases in valuation of the taxpayer's property in accordance with this section may appeal the denial to the entity named in the county or municipal ordinance. The bill does not provide the body that will entertain the appeal. It seems almost fruitless because it seems that it will be the governing body of the local government entity that will decide on a petition and it is likely the very same body that would hear any appeal. We [NMML] do not recommend an appeal to any entity outside the local government structure. The decision on whether to grant a suspension of property tax valuation increases pursuant to a local ordinance ought to rest with and have the final decision rest with the local governmental entity.”

“Finally, the bill is silent as to what happens at the end of the 10 year suspension period. Does the property valuation assume the new assessed value as of the expiration of the 10 year suspension period? If so, the arguments against “lightning tax” increases would apply. Otherwise, either the bill or the ordinance executing the bill would need to be very specific about how the property would be valued beginning in the 11th year following the local government’s action in suspending tax valuation increases.”

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure’s fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

## **PERFORMANCE IMPLICATIONS**

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

Note that this tax abatement may be subject to the financial statement disclosure requirements per GASB Statement No. 77. GASB 77 disclosure requirements are effective for financial statements for periods beginning after December 15, 2015. An assessment of the freeze against the tax abatement criteria specified in GASB 77 would need to be performed by each local

government granting a freeze. If the freeze meets the tax abatement criteria, then disclosure would be required in each entities' financial statements for the fiscal year ending June 30, 2017 et. seq.

### **ADMINISTRATIVE IMPLICATIONS**

HB 174 increases the workload of county or municipality personnel in the administration of the suspension process. The applications must be reviewed by staff and if approved they must be directed to the County Assessor for action. If the application is not approved, the county or municipality must administer an appeal process should an appeal be filed by the entity whose application for suspension of valuation was denied. The county treasurer would be charged with maintaining records on the total amount of tax abated for inclusion in a GASB 77 compliant annual financial statement.

### **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

SJR 14 would limit increases in valuation of real property located in an area designated as an economic development or revitalization zone by a county. This could be the constitutional authority to allow the abatements specified in this bill. The county could designate the area of the proposed commercial development as an economic development or revitalization zone and then have constitutional authority to abate the property taxes for 10 years.

### **TECHNICAL ISSUES**

To the extent that there is a conflict with the general statute, NMSA 1978, Section 7-36-16, the Legislature may consider inserting language that HB174 supersedes current law. Section 7-36-16 NMSA 1978 enumerates the duties of the county assessor.

DFA local government division also weighs in on this issue, "... the most significant issue is that this bill would result in the establishment of a property valuation cap that is not currently included in the New Mexico Constitution. Article 8, Section 1B allows the legislature to provide limitations to annual increases in residential property valuation based on owner-occupancy, age or income. The provisions of this bill appear to be outside of these constitutional limitations."

NMML also challenges the ability of the legislature to enact this concept: "The bill might be in conflict with Art. IX. Sec. 14 of the New Mexico Constitution, the "Anti-donation" clause. There are certain constitutional exceptions to the general proposition that no county or municipality, "except as otherwise provided in this constitution, shall directly or indirectly lend or pledge its credit or make any donation to or in aid of any person, association or public or private corporation. . . . " One of the recognized exceptions is for the purpose of creating new job opportunities, but the constitution speaks in terms of providing "land, buildings or infrastructure. . . , " not a suspension in property tax valuation.

### **OTHER SUBSTANTIVE ISSUES**

This could be considered a "poor man's industrial revenue bond." Big manufacturing or commercial enterprises that promise hundreds or even thousands of jobs can go to a municipality or county and ask for a 30-year property tax abatement. The mechanism is that the sponsoring government "owns" the building and equipment and leases it to the company. The lease

payments are just equal to the depreciation on the building and equipment and the debt service on the notes issued to amortize the bonds issued to permit the county or municipality to build the building and equip it. Billions of dollars of industrial revenue bonds have been issued over the years by various entities. Because the government “owns” the facility and equipment, there is no property tax, except perhaps for a PILT to the local school district. This tax abatement typically lasts for thirty years, at which time the government “sells” the plant and equipment to the company for a nominal sum (since the building is 3/5<sup>th</sup> depreciated and the equipment is worth its salvage value.

However, this IRB mechanism is not available for commercial enterprises or multi-family structures. This bill would allow ten-year full tax abatement for commercial enterprises or multi-family structures. The issue, however, is how many jobs (permanent and construction phase) and how many of those jobs would be occupied by citizens of the sponsoring jurisdiction?

If the NMML/DFA view of the fiscal impact of this bill is correct, it could have a relatively profound impact on commercial development – particularly in rural New Mexico. For multi-family residential the property tax far exceeds the amount of gross receipts tax or compensating tax owed and paid. For retail concerns, the gross receipts tax is passed forward to the buyer and the greatest net tax is the property tax (followed by the income tax). So a large reduction in property taxes to the level of those imposed on vacant land would be a relatively profound incentive.

Current and correct values result in an equitable tax base on which to distribute the burden of property taxes. When values are not allowed to fluctuate with the market value of the property the tax burden shifts to other taxpayers that do not qualify for the suspension.

DFA local government division is also concerned with statutory conflict: “In discussions with the Santa Fe County Assessor’s office, freezing property valuation at the current and correct value in the tax year before the commercial enterprise development project begins could result in the property being valued as vacant land for 10 years after its development. The bill would also prevent a county assessor from valuing improvements to the property for 10 years, which moves valuation further away from its current and correct value. Pursuant to Section 7-36-16 NMSA 1978, county assessors have the responsibility to determine and maintain current and correct values of property. The only exception is the existing 3 percent valuation cap for residential properties permitted by Section 7-36-21.2 NMSA 1978.

According to the New Mexico Association of Counties, some counties, such as Santa Fe, see this bill as a potential economic development tool. However, the counties that have slow or no valuation growth, such as Torrance, could lose property tax revenue as this bill would further delay the county getting to current and correct valuation. Without knowing how many commercial enterprise properties would be granted the 10 year valuation cap by county and municipal governing bodies, it is difficult to determine if the cap would actually result in commercial enterprise developments boosting the local economy by creating jobs and promoting industry, trade or other economic activity.

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

**ALTERNATIVES**

1. Prohibit local governments from freezing at the vacant land level or allow the freeze at that level for a shorter period of time.
2. Value permanent jobs as worth more than construction phase jobs.
3. Allow local governments to freeze property taxes for less than 10 years.
4. Remove “multi-family residential structures” from the allowable properties to be awarded this boon.
5. Allow or require payments in lieu of taxes for school districts operating and debt and perhaps county operating rates if the city is the sponsor of the freeze and the city operating rates if the county is the sponsor.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate

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